

Washington State Patrol Rate Stability

Background

As of the most recent forecast, member contribution rates in the WSPRS are expected to increase from the current 2.00% minimum to 7.97% during the 2007-2009 biennium, and to 8.93% in the 2009-2011 biennium. Historically, the WSPRS member contribution rate was set in statute at 7.00% of salary. When the plan was reformed in 2001, a new funding method and cost-sharing design were incorporated. As a result, member contribution rates will soon exceed the former statutory rate.

Committee Activity

Presentations:

October 19, 2004 - Full Committee
November 9, 2004 - Full Committee

Proposal:

November 9, 2004 - Full Committee

Recommendation to Legislature

Establish a contribution formula for the WSPRS where members pay $\frac{1}{3}$ of the cost of the plan, with a maximum member contribution rate of 7.0%, and the employer pays the remaining cost of the plan.

Staff Contact

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Select Committee on Pension Policy

Washington State Patrol

Rate Stability

(December 15, 2004)

Issue

Contribution rate stability and the current cost-sharing provision in the Washington State Patrol Retirement System (WSPRS) are issues for the Washington State Patrol Trooper's Association. They have forwarded their proposals to the SCPP in recent correspondence and analysis.

As of the most recent forecast, member contribution rates in the WSPRS are expected to increase from the current 2.00% minimum to 7.97% during the 2007-2009 biennium, and to 8.93% in the 2009-2011 biennium. Historically, the WSPRS member contribution rate was set in statute at 7.00% of salary. When the plan was reformed in 2001, a new funding method and cost-sharing design were incorporated. As a result, member contribution rates will soon exceed the former statutory rate. While the Trooper's Association endorses the concept of rate stability, they are also interested in reformulating the current cost-sharing formula.

Staff

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Members Impacted

As of the 2003 valuation there were 1,079 active members of the WSPRS (1,045 in Plan 1 and 34 in Plan 2).

Current Situation

The Washington State Patrol Retirement System (WSPRS) was originally established in 1947, and in 2001 was the last of the Plan 1 design systems to be reformed. Among the numerous modifications to the system were changes to the funding provisions. In the original plan,

member contributions were set at 7.00% in statute with the balance of contributions provided by the employer. The current provisions are a modified cost-sharing design in which members pay half the cost of the plan or 2.00% of pay, whichever is greater.

When the funding provisions were modified, the plan was in fully-funded status and member contributions were 2.00% of pay while employer contributions were 0.00%.

History

From 1995 through 1999, the return on plan assets in the State's retirement funds performed well above the actuarially assumed rate of return. As a result, several plans reached funded ratios significantly above 100%, in essence holding greater assets than there were accrued liabilities. In 1999, the State's contributions were suspended in both the WSPRS and the Law Enforcement Officer's and Fire Fighter's Plan 1 (LEOFF 1) when plan assets exceeded the plan's fully projected benefit liability. In 2000, employee and employer contributions were suspended in LEOFF 1, and employee contributions were lowered to 3% in WSPRS. The 1999 legislature also directed the Joint Committee on Pension Policy (JCPP) to study the method for setting employer and employee contribution rates in the WSPRS during the 2000 interim. During the 2000 interim, JCPP studied and proposed changes to the WSPRS. The JCPP submitted legislation that was enacted in 2001 as Chapter 329. That legislation reformed the WSPRS by:

- Changing the COLA from a simple 2% to a compounded 3% CPI-based adjustment for beneficiaries as well as retirees.
- Changing the employee contribution rate from a fixed 7% to the greater of 2% or the employer rate.
- Excluding prospectively voluntary D.O.T. overtime from the definition of salary.

For new members of the WSPRS commissioned on or after January 1, 2003, the new plan differed from the older plan by:

- Changing from a 2 year to a 5 year Average Final Salary (AFS) for calculating retirement benefits.
- Excluding annual and holiday pay cash-outs from compensation in determining member's AFS.
- Changing military service credit provisions to exclude prior military service and requiring employee contributions for interruptive service.
- Removing the post-retirement death benefit and allowing the member to select an actuarial equivalent benefit option at retirement.
- Changing the pre-retirement death benefit for members not eligible to retire or who have less than ten years of service to a refund of the member's accumulated contributions plus interest. For a member who was eligible to retire or who had at least 10 years of service, the benefit was changed to a reduced accrued benefit or 150 percent of the member's accumulated contributions at the survivor's option.

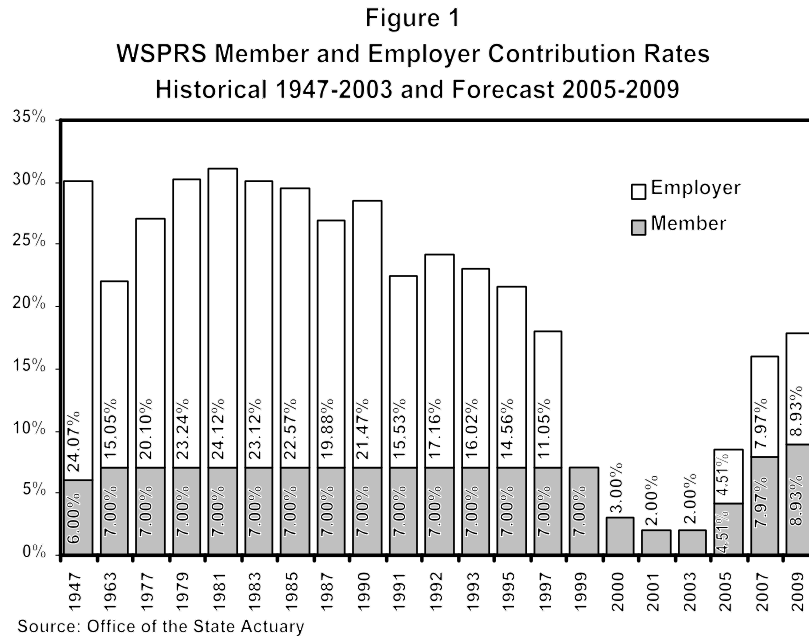
In addition, the legislation provided that the funding of the plan be done on an "aggregate actuarial cost" method, as done for all other Plan 2's. Prior to this change, the system was funded on an "entry age normal" basis.

The legislation also attempted to amend the disability provisions in the WSPRS. The existing provisions gave the Chief a principal role in determining disability. And while injured WSPRS members are eligible for Workers Compensation benefits through the Department of Labor and Industries (L&I), disability retirement benefits have been primarily paid from the WSP operating budget rather than the retirement system or L&I. The sections amending the disability provisions were vetoed because of the possible diminishment of benefits in particular situations.

What is also unusual about the changes made to the WSPRS in 2001, and what makes it distinct from the other Plan 2s, is that those changes did not include a typical Plan 2 funding structure. When the other Plan 2s were created (PERS 2, TRS 2, SERS 2, and LEOFF 2), the original plans were closed, and separate funds and funding methods were established. In the WSPRS there are no separate Plan 1 and Plan 2 funds – all contributions are deposited into the same fund. All members, whether Plan 1 or Plan 2, are part of one actuarial experience group, contributions are calculated with no distinction between the plan members, and all members are subject to the same contribution rate.

Contribution Rate History

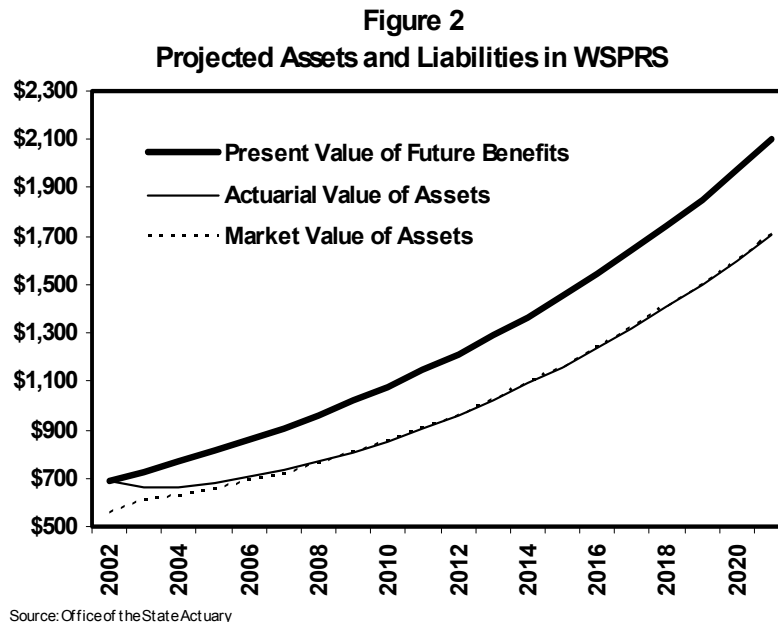
At its creation in 1947, WSPRS member contributions were set at 6% of pay, and the employer rate was approximately 4 times that (see Figure 1). In 1963, the member rate was fixed at 7% of pay, and employer contribution rates have varied between two and three times the member rate. So while the member contribution rate has historically been very stable, the employer contribution rate has fluctuated significantly.



The funding and contribution rate provisions in the WSPRS have, up to 2001, been similar to those of the other Plan 1s. The plan funding was based on the “entry age normal” method, the member rate was set at a constant percent of salary, and the employer rate was whatever else was required to meet the funding needs of the plan including payments to amortize any unfunded liability. All other Plan 1s – PERS, TRS, and LEOFF – still have statutorily fixed member contribution rates of 6% (the LEOFF 1 member contribution rate is currently 0% as the plan is still fully funded). WSPRS is the only Plan 1 design to change its funding method and change its existing member contribution from a fixed percentage to a cost-sharing percent.

After experiencing a funding ratio of 159% in 1999, the WSP Plan is projected to emerge from full funding in the 2005-2007 biennium. The relatively quick reduction of surplus funds in the WSPRS was not just because of the poor investment markets in 2000 and 2001 but also because the plan is open to

new entrants. As new members join, the plan recognizes their liabilities very quickly (see Figure 2), which is then compared with the assets from the single WSPRS fund, including the surplus assets. Contrast this with the surplus funding experience in LEOFF 1: there have been no new members (liabilities) since 1977 and the reduction of surplus funds, as a result, is slower. Member and employer contribution rates in the WSPRS are each expected to surpass 7% in the 2007-2009 biennium.



Because of changes in the WSPRS funding method, member and employer contribution rates are expected to move in unison once the total costs reach and surpass 4% of pay. This is somewhat characteristic of a cost-sharing funding method. The principal difference between the WSPRS and other Plan 2s is the 2% minimum member contribution in the WSPRS; minimum member contributions are not found in the other Plan 2s. As a result of the minimum contribution requirement, WSPRS members will, in the long-run, pay more than half the cost of the plan.

Cost-sharing and Plan Value

Because of the varying degrees of funded status, the value of the retirement plans – the benefits provided to members in retirement – and the long-term level of cost-sharing are not necessarily reflected in the current contribution rates. There are several plans that are not fully funded (see Figure 3) and their

contribution rates are higher to pay for the plans' unfunded actuarially accrued liability. Other plans are in surplus, and depending on the funding method may have lower contributions, or no contributions. Because of these funding differences current contribution rates do not reflect the long-term value of the plans.

Figure 3
Funded Ratios of Plan 1 Systems
and WSPRS 2003

PERS 1	TRS 1	LEOFF 1	WSP
85%	93%	112%	123%

A more appropriate indicator of plan value, or benefit value under a defined benefit plan, is the entry age normal cost of the plan. This prices the plan based on the cost of the benefits and the long-term realization of all actuarial assumptions. In this manner, the contribution rates reflect the demographic characteristics of plan members and the value of the benefits in the plan rather than the short-term gains or losses in plan assets. The normal cost of the various retirement systems and plans are shown in Figure 4.

Figure 4
Entry-Age Normal Contribution Rate and Social Security Contribution
by System and Plan: Total Percent of Pay

Plan	Entry Age Normal Cost			Social Security Tax			Entry Age + Soc Sec		
	Member	Employer*	Total	Member	Employer	Total	Member	Employer	Total
PERS 1	6.00%	5.31%	11.31%	6.20%	6.20%	12.40%	12.20%	11.51%	23.71%
PERS2/3	4.46%	4.46%	8.92%	6.20%	6.20%	12.40%	10.66%	10.66%	21.32%
TRS 1	6.00%	7.30%	13.30%	6.20%	6.20%	12.40%	12.20%	13.50%	25.70%
TRS 2/3	5.43%	5.43%	10.86%	6.20%	6.20%	12.40%	11.63%	11.63%	23.26%
SERS	4.71%	4.71%	9.42%	6.20%	6.20%	12.40%	10.91%	10.91%	21.82%
LEOFF 1	6.00%	22.46%	28.46%	0.00%	0.00%	0.00%	6.00%	22.46%	28.46%
LEOFF 2	8.36%	8.36%	16.71%	0.00%	0.00%	0.00%	8.36%	8.36%	16.71%
WSPRS	10.69%	10.69%	21.38%	0.00%	0.00%	0.00%	10.69%	10.69%	21.38%

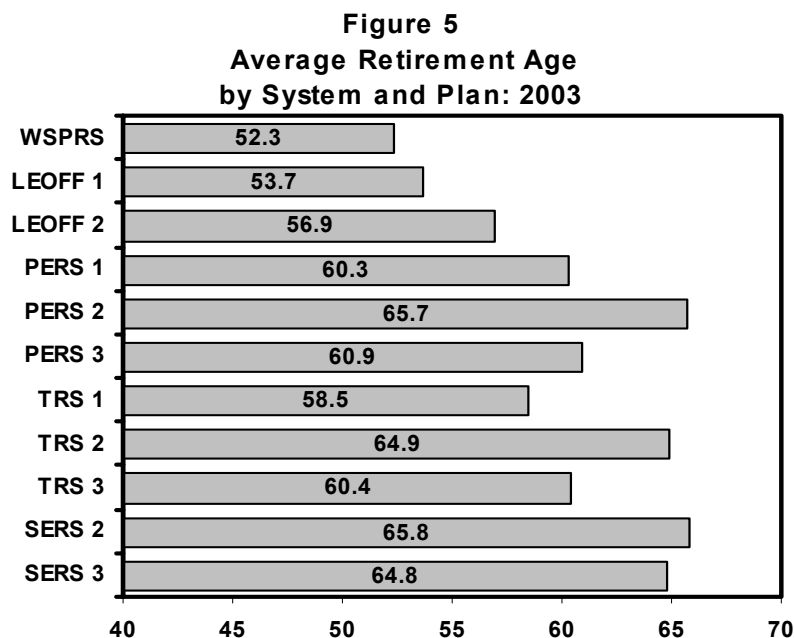
*Does not include contribution rate for Plan 1 UAAL.

Taking into account both State retirement and Social Security, total contributions to Washington's retirement systems can easily surpass 20% of pay in most plans. The employer commitment to Washington's retirement plans, again summing the normal cost plus any employer contributions to Social Security, can surpass 10% of pay. The total employer contribution in

the WSPRS is 10.69% of pay compared to 10.66% on PERS 2/3 and 11.63% in TRS 2/3. The entry age normal cost for the WSPRS is based on the current mix of Plan 1 and Plan 2 members. This rate will decrease as Plan 1 members are replaced by Plan 2 members.

Age Provisions and Plan Value

All Washington's systems and plans have similar benefit formulas (2% of average final compensation × years of service). Such similar provisions will not cause cost differences within the Plan 1s, or within the Plan 2s. The more costly element that will differentiate these systems and plans is the age at which a member is allowed to retire and receive a benefit. The younger the retirement age, the longer a benefit is received, and the costlier the plan. Because of the inherent danger and physical stresses of public-safety occupations, the age and service provisions in WSPRS and the LEOFF Plans allow for full retirement benefits at relatively young ages: at age 50 in LEOFF 1, age 53 in LEOFF 2, and at age 55 or after 25 years of service in WSPRS. Many WSPRS members have become eligible for full benefits before reaching age 50. The average retirement ages in these public-safety plans are reflective of those provisions (see Figure 5) which would make them more costly than the remaining plans.



Three-Legged Stool

The “three-legged-stool” pension model is one in which an individual’s retirement income is derived from three sources: an employer provided pension, personal savings, and Social Security. Social Security benefits are available to all employee groups who elect to join and make contributions. Those contributions are currently 6.2% of pay, up to \$87,000 (indexed) in earnings, for both the employee and employer.

Many public-safety retirement plan members, including WSPRS members, do not pay into the Social Security system. Members of several general public employee retirement plans also do not pay into Social Security, Alaska and Ohio Public Employee’s Retirement System being examples. Plans covering employees who do not pay into Social Security tend to have more generous benefits than those where members do make Social Security contributions. This is a tacit acknowledgment that when one leg of the three-legged stool is absent, one of the other legs must be more substantial.

WSPRS members also do not pay into Medicare. PERS, TRS, and SERS members and their employers each pay 1.45% of salary as contributions to Medicare.

Even if WSPRS members do not pay into Social Security, that does not necessarily mean they won’t inevitably receive Social Security benefits. It is understood that by retiring relatively young, not all members will be permanently leaving the work force. Retired WSPRS members will likely be working in some other public or private-sector job until fully retired; one in which they would probably be contributing to Social Security.

Contributions and Funding in Comparative Systems

Contributions among the comparative states will be different because of the differences in benefit design, funding policies, cost-sharing, and the presence of unfunded liabilities. Employer contributions among the comparison states ranged from 0.00% in Washington to 43.54% in Missouri (see Figure 6).

Figure 6
Comparisons of Provisions in Select State Trooper Plans

	Contribution Rates		Benefit Multiplier: ___% × Years of Service	Benefit Requirements Age / Service
	Employer	Member		
California	32.65%	8.00%	3.0% (max 90%)	50 / 5
Colorado	12.85%	10.00%	2.5%	50 / 25, 55 / 20, 60-64 / rule of 80, 65 / 5
Florida	22.15%	0.00%	3.0%	55 / 6, Any age / 25
Idaho	10.73%	7.65%	2.3% (max 100%)	50 / Rule of 80
Iowa	17.00%	9.35%	2.75% (max 88%)	55 / 22
Minnesota	12.60%	8.40%	3.0%	55 / 3
Missouri	43.54%	0.00%	1.7%	48 / Rule of 80
Ohio	24.50%	10.00%	2.5% up to 20 years, 2.25% 21 to 25 years, 2.00% per year thereafter (max 79.25%)	48 / 25
Oregon	9.49%	6.00%	2.0%	55 / any service, 50 / 25, Any age / 30
Washington	0.00%	2.00%	2.0% (max 75%)	Any age / 25, 55 / Any service

Florida and Missouri are non-contributory plans.

Iowa employer contribution did not include a payment to the plan's unfunded liability.

Missouri employer contribution rate includes a 29.21% payment for the plan's unfunded liability.

California employer contribution rate includes an 18.13% payment for the plan's unfunded liability.

Missouri members pay into Social Security.

Among these comparative systems, only WSPRS has a 50-50 (as long as the costs exceed 4% of pay) cost-sharing design. Most rely on a statutory contribution by the members and a residual contribution by employers to pay the remaining cost of the plan. Two of the plans, Florida and Missouri, are non-contributory plans, meaning the members make no contributions at all.

Benefit design has a direct bearing on the cost and funding requirements of these plans. The California State Patrol plan recently instituted a 3% per year benefit multiplier which will result in a larger benefit and require greater contributions than the 1.7% multiplier used in Missouri. However, Missouri troopers and their employer, pay into Social Security thus providing a benefit that does not show in this accounting.

Funding methods also add to the difficulties in comparing contribution rates. The current funding method in Washington is the aggregate actuarial cost method in which no unfunded actuarially accrued liability (UAAL) is allowed to accumulate outside the plan's normal cost. All of the comparison States use

the “entry age normal” funding method and have varying levels of unfunded liabilities. For instance, in Missouri the great majority of their current employer contributions are to cover the plan’s UAAL. Over half of the employer contributions in the California Highway Patrol plan are payment for the plan’s unfunded liability. Idaho and Colorado’s trooper plans also have unfunded liabilities that add to their employer contribution rates. Iowa’s trooper plan also has a significant unfunded liability that could increase their current employer contribution rate by up to 12 percentage points if they chose to fund it. Unfunded liabilities create generational equity issues in that the cost of unfunded pension liabilities of current retirees are passed to future taxpayers.

LEOFF 2 Comparison

The other open public safety related retirement system in Washington State is the Law Enforcement Officers and Fire Fighters retirement system Plan 2 (LEOFF 2). A new Public Safety Employee’s Retirement System (PSERS) will open in 2006, but until that time LEOFF 2 will be the point of comparison. Benefit provisions in WSPRS 2 and LEOFF 2 are similar in many ways, particularly in terms of vesting, benefit formula, and COLAs. Where the WSPRS differs is in the provision allowing a member with 25 years of service to retire with an unreduced benefit. This is characteristic of the service-based criteria found in the Plan 1 designs and still found in WSPRS 2. This is more costly than the age and service provision in LEOFF 2.

As with all the Plans 2, the WSPRS and LEOFF 2 are similar in that they both use the “aggregate actuarial cost” funding method (see Figure 7). This method reacts quickly to changes in asset returns, and does not allow the accumulation of an unfunded liability outside the plan’s normal cost.

Figure 7
Funding Provisions in WSPRS 2 and LEOFF 2

	WSPRS 2	LEOFF 2
Funding Method	Aggregate Actuarial Cost	
Member Contributions	2% or half the cost of the benefits, whichever is greater.	Half the cost of member benefits
Employer Contributions	(The State is the employer)	30% of the cost of members benefits
State Contributions	Half the cost of members benefits unless total costs are under 4%.	20% of the cost of members benefits

Besides the minimum member contribution in WSPRS, the principal difference in funding policy between the plans is how the employer costs are divided in LEOFF 2. The state is the employer for WSPRS members and pays half the cost of the retirement plan benefits, as long as the costs exceed 4% of pay. While the State is not the employer in LEOFF 2, it still pays 20% of the cost of the benefits, while the actual local government employer pays 30% of the cost of the benefits. A State contribution for those who are local government employees is not found in the other Washington systems and plans; it is likely a design borne of the significant state contributions to the original LEOFF 1 Plan.

Proposed Cost-sharing Formula

The Trooper's association has proposed reworking the cost-sharing formula. The current 50-50 split with a 2.00% member minimum would be changed to $\frac{1}{3}$ member, $\frac{2}{3}$ employer, with the member rate capped at 7%. Historically the plan required 7.00% of pay from the members with the State liable for the remaining costs. This resulted in members paying, on average, about one-third of the plan's costs and the employer (the State) paying about two-thirds.

In a second proposal, the Trooper's Association has also requested a phase-in period before the $\frac{1}{3}$ - $\frac{2}{3}$ formula takes effect. Because their employer has been making no contributions since 1999, they feel their employer should make even larger contributions than are generated in the $\frac{1}{3}$ - $\frac{2}{3}$ formula. They propose that over the next 3 biennia, members would pay 20% of the cost of the plan, with a 2.0% minimum member contribution rate, and their employer would pay the remaining cost of the plan.

Fiscal Impact

Fiscal analysis of this proposed cost-sharing formula show the member contribution rate in the 2005-2007 biennium declining by 1.5% and the employer rate increasing by 1.5%. This would result in an additional \$2.4 million in State contributions to the WSPRS during the 2005-2007 biennium. With a long-term expected normal cost of 21.38%, the current 50-50 cost-sharing would result in member rates and employer rates each trending to 10.69%. Under the $\frac{1}{3}$ - $\frac{2}{3}$, 7% cap proposal, the member rate would reach a maximum of 7% while the employer rate would trend to 14.39%. The 25-year cost to the State would be \$123 million. Under the phase-in proposal, the

member contribution rate would fall by 2.51% and the employer contribution rate would increase by 2.51% in the 2005-2007 biennium. This would result in an additional \$4.0 million in employer contributions in the first two years. The 25-year cost to the state would be \$133.4 million.

Policy Analysis

The policy questions in regards to the WSPRS contribution rate stability issue is whether the plan adheres to the cost-sharing policies outlined for the Plan 2s, whether the current volatile contribution rates are in conflict with existing funding policy, and whether the proposed contribution formula, with the 7% cap, is in keeping with current policy.

Cost-sharing

One of the implicit policies formulated by the Joint Committee on Pension Policy states that "... costs should be shared equally between employees and employers."

When the total funding requirements of the WSPRS are 4% of salary or greater, there is equal cost-sharing. If, as has been the case over the past several years, the plan is fully funded and requires no contributions, then members pay the only contributions to the plan. Since members make contributions when none are necessary but the employer does not, the members will, in the long-run, not share equally in the costs of the plan. The proposed $\frac{1}{3}$ - $\frac{2}{3}$ cost-sharing formula would be consistent with past practices for the WSPRS but inconsistent with current cost-sharing policies of the Plan 2 systems. The prospect of member contribution rates climbing over 7.00% may also raise a Bakenhus issue for existing Plan 1 members. Existing members never paid contributions above 7.00% of pay. The Bakenhus decision does allow for changes in retirement plan provisions as long as the trade-offs are of equivalent value. In the reform of the State Patrol Plan in 2001, existing members and their beneficiaries received a benefit increase in the form of a 3% CPI-based COLA for retirees and survivors; retirees formerly had a 2% simple COLA, and only in 2000 were survivors eligible to receive a 2% simple COLA. Existing members also received more flexibility in providing survivor benefits for their beneficiaries. Though not a permanent benefit, members also received a short term decline in their contribution rate.

Rate Volatility

Within the Finding Chapter (RCW 41.45) is the policy goal to “establish predictable long-term employer contribution rates which will remain a relatively constant proportion of the future state budgets.”

The projected increases in employer and member contribution rates have brought this policy to the forefront in current retirement discussions. The volatility of the contribution rates, both during the recent past and over the next several biennia, is in conflict with this existing funding policy. Legislation has been enacted in the past two sessions to address this volatility, and is expected to smooth out any such future fluctuations (Chapter 11 laws of 2003 extended session, and chapter 93 laws of 2004.)

Rate predictability and stability is an issue impacting all systems and plans, including the WSPRS. In response to this volatility the funding report of the State Actuary, heard by the SCPP in July of this year, included a recommendation to establish minimum Plan 2/3 contribution rates based on a combination of entry age and aggregate methods. The report also recommended that the rate charged employers to fund the Plan 1 unfunded liability not be allowed to decrease until the plans were at a funded ratio of 125%. These recommendations seek to add a greater degree of predictability and stability to the funding of the retirement plans in keeping with existing policies.

In addition, the SCPP Pension Funding Council Subgroup proposed a phase-in of the projected rates increases over the next 3 biennia. While this would incur additional costs to the plans, it would observe the policy of predictability.

Policy Conclusion

Two particular elements within the WSPRS design have policy implications. The presence of a minimum contribution rate for members results in an imbalanced cost-sharing relationship. Without an equivalent minimum contribution rate for the employer, members will not share equally with the State in the cost of the plan. The proposed $\frac{1}{3}$ - $\frac{2}{3}$ contribution formula with a 7% member cap may be in keeping with historical Plan 1 policy, but would be establishing new policy within the Plan 2 systems. The other policy element relates to the stability of the contribution rates; by using the aggregate method to fund the plans, benefits are fully paid over the working lives of the members

and no unfunded liability is allowed to accrue outside the plan's normal cost. This does result in rate volatility which may be in conflict with existing funding policy. However, recent legislation has set in place new smoothing methods and asset corridor measures to address this volatility. Furthermore, additional funding recommendations are before the SCPP this interim which also apply to the WSPRS.

Executive Committee Recommendation

Forward two proposals to the full committee for a public hearing:

Proposal #1: Members pay $\frac{1}{3}$ of the cost of the plan, with a maximum member contribution rate of 7.0%, and the employer pays the remaining cost of the plan.

Proposal #2: During the first 3 biennia members pay 20% of the cost of the plan, with a 2% minimum member contribution rate, and the employer pays the remaining cost of the plan. After 3 biennia, members pay $\frac{1}{3}$ of the cost of the plan, with a maximum member contribution rate of 7.0%, and the employer pays the remaining cost of the plan.

Committee Recommendation

Draft a bill on proposal #1 and forward it to the full legislature.

Bill Drafts

Attached

Fiscal Note

Attached

Administrative Impact

See attached letter from John Charles, Director of Department of Retirement Systems.

Stakeholder Input

Robert Thurston, President
Washington State Troopers Association
See attached correspondence



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DEPARTMENT OF RETIREMENT SYSTEMS
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October 28, 2004

The Honorable Karen Fraser, Chair
The Honorable Steve Conway, Vice-Chair
Select Committee on Pension Policy
Post Office Box 40914
Olympia, Washington 98504-0914

RECEIVED

OCT 28 2004

Office of
The State Actuary

Dear Senator Fraser and Representative Conway:

Subject: Washington State Patrol Rate Stability

At the October 19, 2004 Select Committee on Pension Policy (SCPP) meeting, the Department of Retirement Systems (DRS) was asked to provide administrative input on the issue of rate stability in the Washington State Patrol Retirement System (WSPRS). There are three administrative areas of the WSPRS that are important to note: the funding structure of the plan, the accounting of the contributions, and the reporting of the assets in the Department's Comprehensive Annual Financial Report (CAFR).

Funding

As explained in the report to the SCPP, the funding of the plan had historically been a 1/3 – 2/3 split between member and employer, with a 7 percent maximum member contribution. In the 2001 legislation creating Plan 2 and providing for an enhanced cost of living allowance for retirees, that funding was changed to an employee contribution equal to the greater of 2 percent or the employer rate. However, unlike any other Washington State retirement system with multiple plans, the funding of the benefits for each plan was not separated, even though the benefit structure for Plan 1 and Plan 2 is significantly different. Currently, members of both plans pay the same contribution rate, and all benefits are paid from the same fund.

Accounting

When implementing this 2001 legislation, DRS decided to account for the contributions from each plan separately. While the contributions are invested and benefits are paid from one fund per statutory requirement, the Department accounts for them separately to ensure clear records and provide for historical data regarding the contributions received by members of each plan. This practice would allow the Department to easily account for separate Plan 1 and Plan 2 funds should this be necessary in the future.



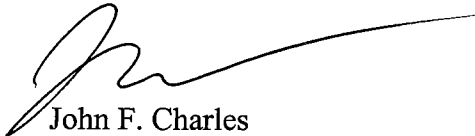
Senator Karen Fraser
Representative Steve Conway
October 28, 2004
Page 2

Reporting

In determining how to report WSPRS Plan 1 and Plan 2 under one fund in the department's and the state's Comprehensive Annual Financial Reports, and in the State Investment Board's Annual Report, we worked with staff from the Office of the State Actuary, the State Investment Board, and the Office of Financial Management, to reach agreement on the appropriate way to accurately represent WSPRS. We agreed that descriptions of the benefit structure and demographic data should be represented for each plan within the system but that all data showing contributions, assets, and liabilities would be represented only at the system level, with footnotes explaining that this includes both Plan 1 and Plan 2. You will see this reporting structure in the 2004 CAFR, published in December.

The issue before the Select Committee on rate stability is complex but the decisions and practices of the Department, when implementing the 2001 legislation, should allow for ease of administration if changes to WSPRS funding policy are made. Please contact me at 664-7312 if you have any further questions.

Sincerely,



John F. Charles
Director



WASHINGTON STATE PATROL TROOPERS ASSOCIATION

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September 9, 2004

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COPY

Senator Karen Fraser
P.O. Box 40422
Olympia, WA 98504-0422

Office of
The State Actuary

Re: WSPRS Contribution Rate Stability

Dear Senator Fraser:

Thank you for taking the time to meet with Rick Jensen and Paul Neal to contribution rate stabilization. We share your concerns, and appreciate your leadership, in this area. All of the systems have seen wide swings in rates in the last six years, but those fluctuations have been most dramatic in the Washington State Patrol Retirement System (WSPRS).

The current contribution rate stabilization recommendation put forward by the State Actuary would require an amendment to the statutes governing contribution rates for the WSPRS. We ask that those amendments incorporate our proposal.

We are proposing a WSPRS contribution formula that is consistent with the statutory history and past practice of the Legislature and the Pension Funding Council:

- 7% cap on member contributions;
- 1/3 – 2/3 member to employer contribution ratio effective July 1, 2005.

I am enclosing a copy of our briefing paper on the issue. I would appreciate it if you could give the Trooper's association fifteen to twenty minutes on the October SCPP agenda to present this issue to the full committee.

We are also concerned about retiree health insurance. There are a number of optional plans authorized by the federal tax code. There also appears to be a lot of confusion about what those plans are and how they work. Please consider making the study and discussion of this issue a top priority for the SCPP's work during the 2005 interim.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'R. Thurston', with a long horizontal stroke extending to the right.

Robert Thurston, President
Washington State Trooper's Association

cc: Matt Smith

Contribution Rate Stability For Trooper Retirement

October 4, 2004

The Trooper's association shares the SPCP's concern for contribution rate stability. We support the idea of working towards a minimum contribution rate that will guard against the wild swings we are currently experiencing. Under the Actuary's current recommendation, those minimum contribution rates would be equal for employers and employees. The unique history of Trooper retirement requires a modified application.

How We Got Here

Up until 2001, the Troopers paid a statutorily fixed 7% contribution rate. Historically, Troopers have paid one-third of the system cost and the State has paid two-thirdsⁱ.

In 1999 the State's contribution to WSPRS dropped to 0.00%, where it has stayed ever since. In 2001 the Legislature changed the funding formulaⁱⁱ greatly reducing the State's obligation. Instead of picking up two-thirds of the cost, the State changed its maximum obligation to one-half. Troopers were required to pick up the slack.

Since 1999 the State has paid nothing while the Troopers have continued to pay. Beginning in 2005, the system cost will exceed 4% of salaryⁱⁱⁱ. At that point the Troopers and the State will each be sharing half of the total cost. Beginning in 2007, Trooper contributions will exceed 7%.

Where We Are

Washington State Troopers appear to get better retirement benefits than other State employees. In reality, the State's current funding commitment to Trooper's retirement is much less. The State makes Social Security Contributions for all its employees - except Troopers.

Current employer retirement contribution policy:

	Employer Pension Contribution Policy	10 year average annual employer contributions
Troopers (WSPRS)	(A) One-half of actuarial cost of WSPRS ^{iv} ;	5.12% of salary
All Other State Employees (PERS 2 plus Social Security)	(A) One-half of actuarial costs of PERS ^v ; PLUS (B) 7.65% of salary for social security and medicare	12.03% of salary

*Prepared by
Washington State Patrol Troopers Association
October 18, 2004*

Prior to 1999, the level of State retirement contributions for Troopers was equivalent to contributions for other State employees. The State didn't contribute to Social Security for Troopers, but it spent more on WSPRS than on PERS. That made sense. In 2001, that one-third/two-thirds contribution ratio was replaced with a ratio of fifty/fifty. By 2007 Trooper contribution rates will exceed the contractually fixed 7% level.

Contribution Rate Stability for Troopers

Raising Trooper contribution rates above 7% violates constitutionally protected Trooper pension rights. Restoring the 7% cap and keeping the cost sharing at 50-50 will not provide adequate funding. The Trooper's propose:

- Trooper contribution rates capped at 7% - one-third of the current 21% normal cost.
- Long-term contribution ratio of 1/3 - 2/3. Adopt same floor as other plans but with 1/3 - 2/3 cost division. This reinstates the old formula and recognizes the lack of employer social security contributions.
- Restore equilibrium with 80-20 phase in. Three bienniums of the State paying less than its share should be offset with three bienniums of the State paying more. As rates go up for the next three biennia, the State should pay 80% of the cost while the Troopers pay 20% of the cost.

Notes

- i. 15.1 % Average annual employer contribution to WSPRS since 1963 (7% employee contribution). 13.74% Average annual employer contributions for other state employees.
- ii. RCW 41.45.0631 (Ch. 329, Laws of 2001) enacted the following formula:
- Troopers pay 2% of salary or one-half of retirement cost, whichever is greater;
 - State pays:
 - Less than Troopers if total cost of system is less than 4%; or
 - One-half of retirement cost if total cost exceeds 4%.
- iii. Projected WSPRS contribution rates from the OSA website:

	2003-05	2005-07	2007-09	2009-11
Troopers	2.00%	4.22%	7.97%	8.93%
Employer	0.00%	4.22%	7.97%	8.93%

- iv. RCW 41.45.0631; the state makes a Medicare contribution of 1.45% for Troopers employed after July 1, 1986.

- v. RCW 41.45.061

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Transfers from State Patrol Highway Account to Motor Vehicle Fund

Biennium	Biennial Transfer	Total Transfer
2001-03	\$48,657,000 ¹	\$48,657,000
2003-05	\$20,000,000 ²	\$68,657,000
2005-07	\$20,000,000 ³	\$88,657,000
2007-09	\$25,000,000	\$113,657,000
2009-11	\$5,000,000	\$118,657,000
2011- 13	\$15,000,000	\$133,657,000
2013 - 15	\$15,000,000	\$148,657,000

Discontinuance of the transfer will provide more than enough funding for the Trooper pension contribution proposal.

¹ch. 14, sec.406, laws of 2001 as amended by sec 404, ch. 359, laws of 2002.

² ch. 360, sec. 405, laws of 2003

³Projected transfers taken from DOT ten-year transportation budget plan submitted to Governor's office with 2005-07 DOT budget.

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Washington State Trooper's Association
October 18, 2004*

Select Committee on Pension Policy

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September 24, 2004

Chief Lowell M. Porter
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Chief Porter:


The Select Committee on Pension Policy (SCPP) will be holding its next hearing on October 19, 2004, from 10:00 am to 1:00 pm in Senate Hearing Room 4. Among the issues being presented will be Washington State Patrol Retirement System (WSPRS) Contribution Rates.

Based on the results of the 2003 actuarial valuation, the Office of the State Actuary and the SCPP forwarded contribution rate recommendations to the Pension Funding Council for the 2005-2007 biennium. The recommended employer and member contribution rates for the WSPRS were 4.51% of pay.

WSPRS member contribution rates are forecast to exceed 7% in the 2007-2009 biennium. The Troopers Association has asked the SCPP to address this issue.

You are welcome to attend the hearing. Any information you may want to share in this regard would be appreciated.

Sincerely,


Robert Wm. Baker
Senior Research Analyst

cc: Senator Karen Fraser, Chair SCPP
Robert Thurston, Washington State Troopers Association

Enclosure

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Representative Gary Alexander

Elaine M. Banks
TRS Retirees

Marty Brown, Director*
Office of Financial Management

Senator Don Carlson

John Charles, Director
Department of Retirement Systems

Representative Steve Conway*
Vice Chair

Representative Larry Crouse

Richard Ford
PERS Retirees

Senator Karen Fraser*
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Representative Bill Fromhold

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TRS and SERS Employers

Bob Keller
PERS Actives

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Doug Miller
PERS Employers

Glenn Olson
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Senator Debbie Regala

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***Executive Committee**

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1 AN ACT Relating to member contribution rates in the Washington
2 state patrol retirement system; amending RCW 41.45.0631; providing an
3 effective date; and declaring an emergency.

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

5 **Sec. 1.** RCW 41.45.0631 and 2001 c 329 s 11 are each amended to
6 read as follows:

7 Beginning July 1, ~~((2001))~~ 2005, the required contribution rate for
8 members of the Washington state patrol retirement system shall be
9 ~~((two))~~ seven percent or ~~((equal to))~~ one-third of the ~~((employer))~~
10 rate adopted under RCW 41.45.060 and 41.45.070 for the Washington state
11 patrol retirement system, whichever is ~~((greater))~~ less. In no event
12 shall the member contribution rate be less than two percent.

13 NEW SECTION. **Sec. 2.** This act is necessary for the immediate
14 preservation of the public peace, health, or safety, or support of the
15 state government and its existing public institutions, and takes effect
16 July 1, 2005.

--- END ---

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:

CODE:

DATE:

BILL NUMBER:

Office of the State Actuary

035

10/27/2004

Z-0190.2/Z-0191.2

SUMMARY OF BILL:

This bill impacts the Washington State Patrol Retirement System by changing the contribution rate setting formula. The bill would establish member contribution rates at 1/3 of the total cost of the system, or 7 percent, whichever is less. However, in no event will the member rate be less than 2 percent. The employer would then be responsible for paying the remaining costs of the system.

Effective Date: July 1, 2005

CURRENT SITUATION:

Currently the member contribution rate in the Washington State Patrol Retirement System is set at half the cost of the system or 2 percent, whichever is greater. The employer is then responsible for the remaining costs of the system. Because of the funding status of the system, member contribution rates have been 2 percent since 2001, and there have been no employer contributions.

MEMBERS IMPACTED:

All 1,079 active members of this system would be affected by this bill.

For members impacted by this bill, there would be no increase in benefits, but there would be a decrease in member contributions.

ASSUMPTIONS:

The 1/3 member, 2/3 employer split would apply for all years beginning July 1, 2005. The rates are rounded to two decimal places after multiplying the total rate by 1/3 and 2/3 (for example, the total rate of 9.02% would be split with 3.01% for the member and 6.01% for the employer).

FISCAL IMPACT:

Description:

This would not change the liabilities of the current plan. It would shift 1/6 of the total contributions from members to employers. It would also change the cost allocation of any future benefit improvements so that the members would only be paying for 1/3 instead of 1/2, and the employer would be responsible for 2/3 of the cost instead of 1/2.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

<i>(Dollars in Millions)</i>	System: Washington State Patrol (WSP)		
	Current	Increase	Total
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	\$727	\$0	\$727
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	\$0	\$0	\$0
Unfunded Liability (PBO) (The Value of the Total Commitment to all Current Members Attributable to Past Service)	(\$124)	\$0	(\$124)

Increase in Contribution Rates: (Effective 7/1/2005)

Employee	(1.50%)
Employer State	1.50%

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

Costs (in Millions):	<u>WSP</u>
2005-2007	
State:	
General Fund	\$0.1
Non-General Fund	<u>2.3</u>
Total State	\$2.4
Local Government	\$0.0
Total Employer	\$2.4
 Total Employee	 (\$2.4)
2007-2009	
State:	
General Fund	\$0.3
Non-General Fund	<u>4.5</u>
Total State	\$4.8
Local Government	\$0.0
Total Employer	\$4.8
 Total Employee	 (\$4.8)
2005-2030	
State:	
General Fund	\$7.4
Non-General Fund	<u>115.9</u>
Total State	\$123.3
Local Government	\$0.0
Total Employer	\$123.3
 Total Employee	 (\$123.3)

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Washington State Patrol Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:
4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This fiscal note is intended for use only during the 2005 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Unfunded Actuarial Accrued Liability (UAAL): The cost of Plan 1 is divided into two pieces:

- The Normal Cost portion is paid over the working lifetime of the Plan 1 active members. The remaining cost is called the UAAL.
- The UAAL is paid for by employers as a percent of the salaries of all plan 1, 2 and 3 members until the year 2024.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.